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No. 07-1002

In The
Supreme Court of the United States

EL TORO MATERIALS COMPANY, INC. and KAREN SUE NAYLOR, CHAPTER 11 TRUSTEE,
Petitioners,

v.

SADDLEBACK VALLEY COMMUNITY CHURCH,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION

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I.
QUESTIONS PRESENTED

1. Whether a lessor's tort damages caused by the debtor's breach of obligations that exist independently of a real property lease, which is also a breach of the lease, are excluded from the damages cap imposed by section 502(b)(6) of the Bankruptcy Code because the tort damages are not "damages resulting from the termination of a lease."

2. Whether the Ninth Circuit's decision in this case is consistent with prior Ninth Circuit, Third Circuit, and Sixth Circuit decisions, which did not involve a landlord asserting tort damages or the application of the damages cap imposed by section 502(b)(6) of the Bankruptcy Code.

II.
PARTIES TO THE PROCEEDING

Petitioner El Toro Materials Company, Inc. ("El Toro") is the debtor in Bankruptcy Case Number SA 02-18913 ES currently pending in the United States Bankruptcy Court for the Central District of California, Santa Ana Division (the "Bankruptcy Court"). El Toro is the plaintiff and counterdefendant in Bankruptcy Court Adversary Proceeding Number SA 03-01486 (the "Adversary Proceeding"), from which the appeal originated. El Toro was the appellee in the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit").

Petitioner Karen Sue Naylor is the chapter 11 trustee of El Toro's bankruptcy estate.

Respondent Saddleback Valley Community Church (the "Church") owns the real property that is the subject of the Adversary Proceeding and is El Toro's former landlord. The Church is the defendant and counterclaimant in the Adversary Proceeding. The Church was the successful appellant in the Ninth Circuit.

III.
CORPORATE DISCLOSURE STATEMENT

The Church is a religious corporation, with its principal place of business in Orange County, California. Under Rule 29.6 of the Rules of the Supreme Court of the United States, the Church discloses that it does not have any parent corporation and no publicly-held corporation owns 10% or more of the Church's stock.

TABLE OF CONTENTS

I. QUESTIONS PRESENTED i

II. PARTIES TO THE PROCEEDING ii

III. CORPORATE DISCLOSURE STATEMENT iii

TABLE OF CONTENTS iv

TABLE OF AUTHORITIES vii

IV. STATEMENT OF THE BASIS OF APPELLATE JURISDICTION 1

V. STATUTORY PROVISIONS 2

VI. STATEMENT OF THE CASE 3

VII. STATEMENT OF FACTS 5

VIII. REASONS FOR DENYING THE PETITION 9

A. The Ninth Circuit's Holding That Section 502(b)(6) Does Not Cap Tort Damages Caused By A Breach Of Obligations That Exist Independently Of The Lease Is Correct And Is Consistent With The Express Language And Legislative History Of The Statute. 9

B. The Ninth Circuit's Holding That The Church's Tort Damages Are Not Capped By Section 502(b)(6) Does Not Conflict With Its Own Decision In *TreeSource* 13

C. The Ninth Circuit's Holding That The Church's Tort Claims Do Not Result From Termination Of The Lease And Thus Are Not Capped By Section 502(b)(6) Does Not Conflict With Decisions By The Third Circuit And Sixth Circuit. 15

D. The Court of Appeals Has Not Decided An Important Question Of Law That Should Be Settled By This Court. 19

IX. CONCLUSION 31

APPENDIX

A. United States Code, Title 11, section 365 .. 1b

B. United States Code, Title 11, section 502 . 19b

C. California Civil Code, section 826 ..... 25b

D. California Civil Code, section 3334 ..... 26b

E. California Civil Code, section 3479 ..... 27b

F. California Civil Code, section 3491 ..... 28b

G. California Civil Code, section 3501 ..... 29b

H. California Code of Civil Procedure, section 732 ..... 30b

I. California Public Resources Code, section 2710, et seq.[1] 31b

J. Orange County Zoning Code, Sand and Gravel Extraction District Code of Orange County, Title 17, Chapter 17.32, section 17.32.070 ..... 45b

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[1] Due to the length of the Surface Mining and Reclamation Act of 1975 ("SMARA"), only the relevant portions of SMARA are included herein.

TABLE OF AUTHORITIES

CASES

Applied Equipment Corp. v. Litton Saudi Arabia Ltd.,
7 Cal.4th 503 (Cal. 1994) 23, 25

Capitol Industries, Inc. v. Regal Cinemas, Inc. (In re Regal Cinemas, Inc.),
393 F.3d 647 (6th Cir. 2004) 17, 18

Castillo v. Friedman,
197 Cal. App. 3d Supp. 6 (Cal. Super. Ct., App. Div. 1987) 25, 26

Don v. Trojan Constr. Co.,
178 Cal. App. 2d 135 (Cal. Ct. App. 1960) ... 28

First Nat'l Bank v. FDIC,
79 F.3d 362 (3d Cir. 1996) 15, 16, 18

Herond v. Bonsall,
60 Cal.App.2d 152 (Cal. Ct. App. 1943) .. 27, 28

In re Atlantic Container Corp.,
133 B.R. 980 (Bankr. N.D. Ill. 1991) 18

In re Bob's Sea Ray Boats,
143 B.R. 229 (Bankr. D. N.D. 1992) 18

In re Farley, Inc.,
146 B.R. 739 (Bankr. N.D. Ill. 1992) 18

International Coins & Currency, Inc. v. Barmar Corp. (In re International Coins & Currency, Inc.),
18 B.R. 335 (Bankr. D. Vt. 1982) 18

Jones v. Kelly,
208 Cal. 251 (Cal. 1929) 23, 24, 25

K-4, Inc. v. Midway Engineered Wood Products, Inc. (In re TreeSource Indus., Inc.),
363 F.3d 994 (9th Cir. 2004) 3, 4, 13, 14, 15

Kuske v. McSheridan (In re McSheridan),
184 B.R. 91 (B.A.P. 9th Cir. 1995) 4, 16

Malden Mills Indus., Inc. v. Maroun (In re Malden Mills Indus., Inc.),
303 B.R. 688 (B.A.P. 1st Cir. 2004) 28

Muro v. Superior Court,
184 Cal. App. 3d 1089 (Cal. Ct. App. 1986) .. 24

Pacifica Homeowners' Assn. v. Wesley Palms Retirement Community,
178 Cal. App. 3d 1147 (Cal. Ct. App. 1986) .. 25

Pappas v. Carson,
50 Cal.App.3d 261 (Cal. Ct. Ap. 1975) 24

Peter Kiewit Sons' Co. v. Richmond Redevelopment Agency,
178 Cal. App. 3d 435 (Cal. Ct. App. 1986) . 27, 28

Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.),
306 B.R. 295 (B.A.P. 9th Cir. 2004) 12

Rich v. New York Cent. & H. R. R. R. Co.,
87 N. Y. 382 24

Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co.),
504 F.3d 978 (9th Cir. 2007) .. 1, 4, 11-14, 21, 22

Smith v. Cap Concrete, Inc.,
133 Cal. App. 3d 769 (Cal. Ct. App. 1982) ... 29

Stoiber v. Honeychuck,
101 Cal. App. 3d 903 (Cal. Ct. App. 1980) ... 23

United States v. Ron Pair Enters. Inc.,
489 U.S. 235 (1989) 9

Wilson v. Interlake Steel Co.,
32 Cal. 3d 229 (Cal. 1982) 27

STATUTES

11 U.S.C. §§ 101 *et seq.* 1
11 U.S.C. § 365 2
11 U.S.C. § 502 2
11 U.S.C. § 502(b)(6) ..... *passim*
11 U.S.C. § 502(e)(1) 17, 18
11 U.S.C. § 523(a)(2)(A) 20
11 U.S.C. § 523(a)(4) 20
11 U.S.C. § 523(a)(6) 20
11 U.S.C. § 523(a)(9) 20
11 U.S.C. § 1166 26
12 U.S.C. § 1821(e)(4) 15, 16
28 U.S.C. §§ 157(b)(1), (b)(2)(b) 1
28 U.S.C. §§ 158(a)(1), (b), (c) 1
28 U.S.C. § 158(d) 1, 2

28 U.S.C. § 959(b) 26
28 U.S.C. § 1334 1
Cal. Civ. Code § 826 ..... 2, 28
Cal. Civ. Code § 3334 ..... 2, 27
Cal. Civ. Code § 3479 ..... 2, 26, 27
Cal. Civ. Code § 3491 ..... 2, 26
Cal. Civ. Code § 3501 ..... 2, 26
Cal. Code Civ. Proc. § 732 ..... 3, 28
Cal. Pub. Res. Code § 2710 ..... 3, 5
Orange County Zoning Code, Sand and Gravel Extraction District Code of Orange County, Tit. 17, Ch. 17.32, sec. 17.32.070 ..... 3, 5

RULES

FRBP 7054 1
FRCP 54(b) 1

IV.
STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

The Petition originates from an objection to claim and the Adversary Proceeding in El Toro's chapter 11[2] bankruptcy case. The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157(b)(1), (b)(2)(B), and 1334(b). The Bankruptcy Court granted partial summary judgment and certified its judgment as final under FRCP 54(b), made applicable by FRBP 7054. Pet'r App. E at A82-A95.

El Toro and the Church cross-appealed to the United States Bankruptcy Appellate Panel of the Ninth Circuit (the "BAP"), which had jurisdiction under 28 U.S.C. §§ 158(a)(1), (b), and (c). The BAP reversed the Bankruptcy Court and remanded the proceeding. Pet'r App. D at A36-A81.

The Church appealed to the Ninth Circuit, which had jurisdiction under 28 U.S.C. § 158(d). On October 1, 2007, the Ninth Circuit filed its Opinion reversing the BAP and remanding the proceeding. Pet'r App. C at A23-35; Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co.), 504 F.3d 978 (9th Cir. 2007). On November 6, 2007, the Ninth Circuit denied the Petitioners' petition for

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[2] Unless otherwise stated, all chapter and section references herein are to the Bankruptcy Code, 11 U.S.C. §§ 101, et seq., as amended. "FRBP" references are to the Federal Rules of Bankruptcy Procedure, and "FRCP" references are to the Federal Rules of Civil Procedure.

rehearing and rehearing en banc. Pet'r App. B at A21-22.

Petitioners then filed their Petition for Writ of Certiorari. This Court has jurisdiction under 28 U.S.C. § 158(d).

V.
STATUTORY PROVISIONS

This case involves the following statutes. The full text is set forth in Respondent's Appendix:

A. United States Code, Title 11, section 365. Resp't App. A at 1b-18b;

B. United States Code, Title 11, section 502. Resp't App. B at 19b-24b;

C. California Civil Code, section 826. Resp't App. C at 25b;

D. California Civil Code, section 3334. Resp't App. D at 26b;

E. California Civil Code, section 3479. Resp't App. E at 27b;

F. California Civil Code, section 3491. Resp't App. F at 28b;

G. California Civil Code, section 3501. Resp't App. G at 29b;

H. California Code of Civil Procedure, section 732. Resp't App. H at 30b;

I. California Public Resources Code, section 2710, et seq. Resp't App. I at 31b-44b; and

J. Orange County Zoning Code, Sand and Gravel Extraction District Code of Orange County, Title 17, Chapter 17.32, section 17.32.070. Resp't App. J at 45b-48b.

VI.
STATEMENT OF THE CASE

The Petition seeks review of a Ninth Circuit decision holding that a landlord's tort damages caused by a debtor's breach of obligations that exist independently of a real property lease are not capped by section 502(b)(6), which places a limit on the recovery of "damages resulting from the termination of a lease of real property." 11 U.S.C. § 502(b)(6). The Petitioners contend the Ninth Circuit's decision is inconsistent with its prior decision in K-4, Inc. v. Midway Engineered Wood Products, Inc. (In re TreeSource Indus., Inc.), 363 F.3d 994 (9th Cir. 2004) ("TreeSource") and with decisions by the Third and Sixth Circuits. Contrary to the Petitioners' contention, and as held by the Ninth Circuit herein, the TreeSource decision does not conflict with the Ninth Circuit's decision in this case. Also contrary to Petitioners' contention, no split exists among the circuits in cases that have directly decided the issue of whether the section 502(b)(6) cap limits tort damages based on a breach of obligations that exist independently of a terminated lease.

The Ninth Circuit also appropriately overruled the BAP's decision in Kuske v. McSheridan (In re McSheridan), 184 B.R. 91 (B.A.P. 9th Cir. 1995) ("McSheridan"), "[t]o the extent that McSheridan holds section 502(b)(6) to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenants failure to complete a lease term." In re El Toro Materials Co., 504 F.3d at 981-82. In so doing, the Ninth Circuit accurately observed that it was not bound by McSheridan because it was a BAP decision and noted that two of three BAP panel judges in this case filed concurring opinions expressing reservations about the opinion and foreshadowing that "'it may be doubted that McSheridan . . . would survive scrutiny by the court of appeals.'" Id. at 982 n.7 (citation omitted). These same two BAP judges stated they reached their conclusions "reluctantly," that the result was "potentially very harsh," and they found contrary authority outside the Ninth Circuit to be "more persuasive." Pet'r App. D at A74-A79.

The Ninth Circuit's interpretation and application of section 502(b)(6) are consistent with the express statutory text, the legislative history, and the Ninth Circuit's earlier decision in TreeSource. Further, there is no split among the circuits in cases expressly deciding whether section 502(b)(6) caps tort damages caused by the breach of obligations independent of a lease. Because there is no important question of federal law that requires this Court's involvement, and because the Ninth Circuit's decision is correct, this Court should deny the Petition.

VII.
STATEMENT OF FACTS

From 1977 to April 2003, El Toro conducted mining operations on property located in Orange County, California (the "Subject Property" or "East Parcel"). Pet'r App. D at A39, A44-A45. It also conducted a sand-washing operation to produce commercial-grade sand. Id. at A39. El Toro's operations produced more than 1,000,000 tons (650,000 cubic yards) of water-saturated waste byproduct ("Wet Clay"), rubble, and debris that El Toro stockpiled on the East Parcel and then abandoned when it left the premises. Id. at A43-A44, A44 n.5.

El Toro's operations were governed by a myriad of governmental requirements. These included El Toro's Conditional Use Permits, Sand and Gravel Permits, and Grading Permits (collectively, "CUPs"), conditions imposed on its tract maps, mandates imposed by the California Surface Mining and Reclamation Act of 1975 contained in California Public Resources Code section 2710, et seq. ("SMARA"), the Reclamation Plan prepared by El Toro and approved by Orange County in 1992 (the "Reclamation Plan"), and the mandates of section 17.32.070 of the Orange County Zoning Code contained in the Sand and Gravel Extraction District Code of Orange County, Title 17, Chapter 17.32 of the codified ordinances of Orange County (the "Sand and Gravel Code") (collectively, the "Governmental Requirements"). The Governmental Requirements obligated El Toro, among other things:

- To regularly remove from the premises (throughout the Lease term) or dispose of in a

manner approved by the Assistant Director of the EMA all materials El Toro separated from the mined sand by the washing process and accumulated in its siltation ponds.

- To remove all buildings, machinery, and appurtenant facilities within six months after the date El Toro completed mining activities on the Subject Property.

- To reclaim and re-grade the Subject Property to elevations and contours set forth in the Reclamation Plan, to complete reclamation in accordance with SMARA, the Sand and Gravel Code, and the other Governmental Requirements, and to complete the reclamation within one year after El Toro's termination of its mining operations on the Subject Property.

In 1988, Baker Ranch owned the Subject Property and additional adjacent acreage. Pet'r App. D at A40. In about November 1988, Baker Ranch, as lessor, and El Toro, as lessee, signed a written lease for the Subject Property (the "Lease"). Id. The Lease term was ten years and seven months, expiring on May 31, 1999. Id. The Lease required El Toro to comply with all laws and ordinances, including remediating and re-grading the Subject Property in accordance with the Governmental Requirements. Id. at A40-A42.

El Toro's operations included two parcels: the East Parcel, which the Church purchased in 1999, and the West Parcel, which Baker Ranch retained. Pet'r App. D at A42. When the Church purchased the East Parcel in 1999, it became El Toro's landlord. Id. at

A42-A43. Pursuant to a Letter Agreement between the Church and El Toro, the parties agreed to extend the Lease term and agreed that the Lease could be terminated by the Church by serving a two-year termination notice. Id.

On December 14, 2001, the Church served El Toro with a two-year Lease termination notice, stating El Toro's tenancy on the Subject Property would end in December 2003. Pet'r App. D at A43. The two-year notice would have allowed El Toro time to comply with its reclamation obligations, which included removal of the stockpiled Wet Clay. Rather than fulfilling its obligations under the Lease and the Governmental Requirements, El Toro filed a voluntary chapter 11 bankruptcy petition in November 2002. Id.

In January 2003, El Toro and the Church signed a stipulation, agreeing that El Toro's Lease of the East Parcel was rejected pursuant to section 365 and that El Toro would vacate the Subject Property by April 30, 2003 (the "Rejection Stipulation"). Id. at A44-A45. The Church agreed to extend El Toro's occupancy to this date, despite El Toro's earlier rejection of the Lease, based on El Toro's representations that it needed additional time to remove the stockpiled Wet Clay and its equipment from the site. On January 27, 2003, the Bankruptcy Court entered an order approving the Rejection Stipulation. Id. at A45.

On April 30, 2003, El Toro vacated the Subject Property. Pet'r App. D at A45. But El Toro left behind more than 1,000,000 tons of Wet Clay, and debris, rubble, buildings, machinery, and equipment. Id. at A43-A46. Although El Toro surrendered possession of

the Subject Property, the Church gave El Toro the right to re-enter the site during the next several months to perform its Reclamation Plan, comply with its CUPs, and fulfill its related obligations imposed by the Governmental Requirements. El Toro refused.

The Church did not consent to El Toro's continued occupancy of the Subject Property with its stockpiled Wet Clay, equipment, and rubble, and the Church has demanded repeatedly that El Toro remove them. Their continued presence on the East Parcel significantly diminishes the property's value and inhibits the Church's use and enjoyment of its land.

The Church filed a Proof of Claim for $23 million in El Toro's bankruptcy case. Pet'r App. D at A43. This substantially exceeded El Toro's rent of approximately $28,000 per month. Pet'r App. C at A29. Petitioners inaccurately assert that the claim was based upon El Toro's failure to remove the stockpile "pursuant to the covenants of the lease." Pet. at 14. In fact, the Proof of Claim expressly asserts that El Toro's failure to regularly remove the materials and instead stockpiling them over a period of years, violated the Governmental Requirements. The Church's Amended Counterclaim reasserts these same contentions by alleging that El Toro's actions gave rise to claims in waste, private and public nuisance, and trespass, as well as breach of contract. Pet'r App. D at A45-A46.

El Toro's obligations to remove the Wet Clay, debris, rubble, and equipment, and to re-contour and remediate the Subject Property, are imposed both by the Lease and by the Governmental Requirements. Importantly, none of the obligations under the

Governmental Requirements are triggered by termination of El Toro's Lease. Instead, all of these obligations exist even if the Lease had not been executed, enforced, rejected, or terminated.

VIII.
REASONS FOR DENYING THE PETITION

A. The Ninth Circuit's Holding That Section 502(b)(6) Does Not Cap Tort Damages Caused By A Breach Of Obligations That Exist Independently Of The Lease Is Correct And Is Consistent With The Express Language And Legislative History Of The Statute.

The threshold issue addressed by the Ninth Circuit is a question of statutory interpretation: does the language of section 502(b)(6) cap only damages resulting from the termination of a debtor's lease of real property? The Ninth Circuit correctly held "yes."

When resolving this question, the first task is to look at the plain language of the statute. It is well-settled law that the plain meaning of a statute is conclusive, except in rare cases where the literal application produces results contrary to the intentions of the drafter and, in such cases, the drafter's intentions control. See United States v. Ron Pair Enters. Inc., 489 U.S. 235, 242 (1989).

Section 502(b)(6) provides,

> (b) Except as provided in subsections [omitted], if such objection to a claim is made, the court, after notice and a hearing, shall determine the

> amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount except to the extent that –
>
> (6) if such claim is the claim of a lessor ***for damages resulting from the termination of a lease of real property,*** such claim exceeds –
>
> (A) the ***rent reserved*** by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any ***unpaid rent*** due under such lease, without acceleration, on the earlier of such dates.

11 U.S.C. § 502(b)(6) (emphasis added).

Based on the plain and unambiguous language of section 502(b)(6), the Ninth Circuit held the statute applies only to claims of a lessor ***for damages resulting from the termination of a lease of real property***, and thus does not apply to the Church's claims for waste, nuisance, and trespass because they

did not result from the rejection of El Toro's Lease. In reaching this conclusion, the Ninth Circuit stated:

> [T]he harm to Saddleback's property existed whether or not the lease was rejected. A simple test reveals whether the damages result from the rejection of the lease: Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it? Here, Saddleback would still have the same claim it brings today had El Toro accepted the lease and committed to finish its term: The pile of dirt would still be allegedly trespassing on Saddleback's land and Saddleback still would have the same basis for its theories of nuisance, waste and breach of contract. The million-ton heap of dirt was not put there by the rejection of the lease – it was put there by the actions and inactions of El Toro in preparing to turn over the site.

In re El Toro Materials Co., 504 F.3d at 981.

The Ninth Circuit expressly recognized that El Toro's obligations to remove the 1,000,000 tons of Wet Clay were imposed not only by the Lease but also by numerous Governmental Requirements, including El Toro's CUPs and Reclamation Plan, SMARA, the Sand and Gravel Code, and California tort law, all of which obligated El Toro to remediate the site whether or not El Toro rejected or assumed its Lease.

The Ninth Circuit therefore applied the plain statutory language of section 502(b)(6) and held that

the statute caps only claims for "damages resulting from the termination of a lease of real property" and thus does not limit the Church's recovery for damages caused by El Toro's tortious breach of obligations imposed independently of its Lease. See In re El Toro Materials Co., 504 F.3d at 980-81. Because the language of section 502(b)(6) is clear and unambiguous, an analysis of the legislative history is unnecessary.

As the Ninth Circuit correctly observed, however, even if legislative history is consulted, it is consistent with the plain language of the statute and supports the Ninth Circuit's decision. See In re El Toro Materials Co., 504 F.3d at 979-80. The Ninth Circuit reviewed the legislative history and concluded that section 502(b)(6) and its predecessor statutes were designed to limit damages for a landlord's lost rental income. See id. The Ninth Circuit reasoned that "[t]he structure of the cap – measured as a fraction of the remaining term – suggests that damages other than those based on a loss of future rental income are not subject to the cap." Id. at 980. Citing the same legislative history, a concurring opinion of the BAP observed in an earlier case, "[section] 502(b)(6) . . . reflect[s] a Congressional balance between allowing the creditor with the ***big rent*** . . . claim to be paid a reasonable sum without unfairly diluting or squeezing out the other creditors." Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.), 306 B.R. 295, 306 (B.A.P. 9th Cir. 2004) (emphasis added). Here, the Church's tort claims are not based on any damages for past or future rent.

In sum, the legislative history confirms section 502(b)(6) is intended to prevent the dilution of general unsecured creditors' claims based on rental obligations contained in a long-term lease of real property. The legislative history does not support Petitioners' assertion that the statute is intended to apply to all damage claims, including ones that are based on a breach of obligations existing independently of a real property lease. The Ninth Circuit thus correctly interpreted the plain statutory language, which is consistent with the statute's legislative history, and appropriately held that section 502(b)(6) caps only claims resulting from the termination of a lease, and therefore, does not limit the Church's tort damages in this case because they do not depend on whether the Lease was rejected or terminated.

B. The Ninth Circuit's Holding That The Church's Tort Damages Are Not Capped By Section 502(b)(6) Does Not Conflict With Its Own Decision In *TreeSource*.

Petitioners assert that the Ninth Circuit's decision in this case conflicts with the Ninth Circuit's prior decision in TreeSource. Pet. at 23-33. However, as the Ninth Circuit notes in its opinion in this case, TreeSource is clearly distinguishable and the two cases are not in conflict. See In re El Toro Materials Co., 504 F.3d at 981 n.5.

TreeSource did not even address the application of section 502(b)(6). The issue in TreeSource was whether damages caused by the debtor's breach of a lease provision requiring the tenant to remove a concrete slab and to restore the premises to its pre-

lease condition gave the landlord a pre-petition general unsecured claim or a post-petition administrative expense claim that entitled the landlord to a priority distribution from the debtor's estate. See TreeSource, 363 F.3d at 995. In other words, the issue in TreeSource dealt with the prioritization of the landlord's claim, and the case did not even discuss whether the claim was subject to the 502(b)(6) cap. The Ninth Circuit stressed this distinction when holding that its ruling herein is consistent with its earlier decision in TreeSource, stating:

> Our ruling is consistent with [TreeSource] . . . . There we determined the priority of a claim for failure to remove materials from the premises [citation], whereas today we decide whether similar claims are capped by the section 502(b)(6) limitation. Prioritization of the claim is a separate issue from determining the amount of the claim that will be permitted.

El Toro Materials Co., 504 F.3d at 981 n. 5 (citation omitted). Equally significant, TreeSource did not consider a tenant's liability for tort claims based on breaches of obligations existing independently of a lease.

TreeSource is simply irrelevant to this case. TreeSource did not deal with the section 502(b)(6) cap and did not discuss, much less hold, that damages for tort claims that exist independently of the lease are capped by this statute. Also, the Church acknowledges it has a general unsecured claim and it is not asserting it is entitled to a priority distribution. To the contrary, the Church is merely requesting that it be treated the

same as El Toro's other unsecured creditors. As the Ninth Circuit correctly stated, its ruling does not conflict with its prior decision in TreeSource.

C. The Ninth Circuit's Holding That The Church's Tort Claims Do Not Result From Termination Of The Lease And Thus Are Not Capped By Section 502(b)(6) Does Not Conflict With Decisions By The Third Circuit And Sixth Circuit.

The Petitioners assert that the Ninth Circuit's decision in this case conflicts with decisions of the Third Circuit and the Sixth Circuit. Pet. at 33-38. Petitioners are incorrect. Neither the Third Circuit nor the Sixth Circuit decisions cited by the Petitioners discuss, much less hold, that tort damages for breaching obligations independent of a lease of real property are capped by section 502(b)(6). Indeed, neither case directly involves the application of this statute. There is thus no split of authority among the circuits on the issue decided by the Ninth Circuit here.

The Petitioners cite First Nat'l Bank v. FDIC, 79 F.3d 362 (3d Cir. 1996), in support of their erroneous argument that the Ninth Circuit's decision conflicts with a Third Circuit decision. The issue in First Nat'l Bank was whether the Federal Deposit Insurance Corporation ("FDIC") was required under 12 U.S.C. section 1821(e)(4), which is part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), to pay for certain lease-mandated structural repairs and modifications to a building after the receiver of a failed bank had disaffirmed its lease. See id. at 364. Under FIRREA, a receiver who

disaffirms a lease is not liable for any damages for the disaffirment, except for "contractual rent" before a specified date and certain sums for "unpaid rent" thereafter. See id. at 365-66. The court analyzed whether damages for the cost of repair resulted from the disaffirment of the lease, and in doing so, considered the BAP decision in McSheridan, which it characterized as rejecting an argument that certain damages based on pre-petition breaches of covenants were not "termination damages." See id. at 367. The court held that under FIRREA the cost of repair damages were limited because to hold otherwise would render another section in FIRREA "superfluous." See id. The court thus concluded that the claimant could collect "unpaid rent" under section 1821(e)(4)(B), as defined by FIRREA, until the receiver is appointed, and "contractual rent," as defined by FIRREA, that accrued from the date that the notice of disaffirment or repudiation was mailed, or the date it became effective, whichever was later. See id. at 368-70.

First Nat'l Bank dealt only with the interpretation of terms in FIRREA, primarily those involving the definitions of "unpaid rent" and "contractual rent" in the context of that statutory scheme and these terms are not even used in section 502(b)(6). Equally significant, First Nat'l Bank does not address, much less hold, that a party in either bankruptcy or receivership is insulated from tort liability caused by a breach of obligations that exist independently of a terminated or disaffirmed lease of real property. The Ninth Circuit's holding in this case does not conflict with the Third Circuit's decision in First Nat'l Bank.

The Petitioners also cite Capitol Industries, Inc. v. Regal Cinemas, Inc. (In re Regal Cinemas, Inc.), 393 F.3d 647 (6th Cir. 2004), in support of their assertion that the Ninth Circuit's decision in this case conflicts with a Sixth Circuit decision. The issue in Capitol Industries was whether a creditor's contractual indemnification claim against the debtor should be disallowed under section 502(e)(1) – a provision of the Bankruptcy Code that applies to "any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor . . . ." See id. at 649-50 (citing 11 U.S.C. § 502(e)(1)).

In Capitol Industries, the bankruptcy estate paid the landlord's claim which was admittedly capped under section 502(b)(6) and the guarantor of the rejected lease asserted a claim against the bankruptcy estate for contractual indemnification. Capitol Industries, 393 F.3d at 649. The bankruptcy court disallowed the guarantor's claim under section 502(e)(1). See id. On appeal, the guarantor argued that its claim included more than just lease rejection damages because some of its recovery "sprang from contract claims that did not relate to rent under the lease" and thus, should not have been disallowed. See id. The appellate court found that the contractual indemnification claim fell within section 502(e)(1) and affirmed the lower court. See id. at 650-51. The Court did not even address, let alone "necessarily hold," what claims were capped by section 502(b)(6). See Pet. at 34.

The Capitol Industries case is inapplicable because, aside from mentioning briefly that the landlord's claim

was capped under section 502(b)(6), the case dealt only with disallowance of claims under section 502(e)(1). Equally significant, as with First Nat'l Bank, the case did not address, much less hold, that liability for tort claims that arise independently of a lease are capped by 502(b)(6). The Ninth Circuit's holding in this case does not conflict with the Sixth Circuit's Capitol Industries decision.

In contrast with the cases relied upon by the Petitioners – none of which expressly considered the issue of whether damages caused by a tenant's breach of obligations that exist independently of the Lease are capped by section 502(b)(6) – cases that have expressly ruled on the issue have rejected the Petitioners' position. These cases include, among others, In re Bob's Sea Ray Boats, 143 B.R. 229, 231-32 (Bankr. D. N.D. 1992) (damages for waste, trespass, and nuisance are not caused by lease termination and thus are not capped by section 502(b)(6)); In re Farley, Inc., 146 B.R. 739, 746 (Bankr. N.D. Ill. 1992) (conversion damages for items wrongfully removed from premises are not lease termination damages and thus are not capped by section 502(b)(6)); In re Atlantic Container Corp., 133 B.R. 980, 987-88 (Bankr. N.D. Ill. 1991) (intentional damages to the premises are not lease termination damages and thus are not capped by section 502(b)(6); and International Coins & Currency, Inc. v. Barmar Corp. (In re International Coins & Currency, Inc.), 18 B.R. 335, 338 (Bankr. D. Vt. 1982) (damages caused by "malicious" [and therefore tortious] conduct are not capped by section 502(b)(6)). These cases are consistent with the plain language of section 502(b)(6) that limits the cap to claims resulting from the termination of a lease of real property, the

section's legislative history, and sound public policy, which is furthered by not insulating a tort-feasor from the economic harm inflicted by his wrongful injury to another's property.

D. The Court of Appeals Has Not Decided An Important Question Of Law That Should Be Settled By This Court.

The Petitioners assert that to the extent section 502(b)(6) can be avoided by a landlord asserting uncapped tort claims, it would in effect "eviscerate" the section 502(b)(6) cap and would thwart the will of Congress. Pet. at 8. Significantly, the Petitioners do not cite any statutory language, legislative history, or case law supporting their argument. This is because the statutory language, legislative history, interpretation of the Bankruptcy Code as an integrated whole, and settled state law, all support the Ninth Circuit's opinion.

As previously discussed, the legislative history of section 502(b)(6) supports the conclusion that the "will of Congress" was to prevent the dilution of general unsecured creditors' claims based on rental obligations contained in a long-term lease of real property. Nothing in the legislative history supports a conclusion that Congress intended to cap liability for obligations that exist independently of a terminated lease.

A construction of the Bankruptcy Code as an integrated whole supports the interpretation based on the plain language of the statute itself. Consideration of other Bankruptcy Code provisions establishes that Congress knows how to address tort claims when it

intends to affect them. Accordingly, section 523(a)(2)(A) states that a discharge will not relieve an individual debtor from any debt for money, property, services, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's financial condition. See 11 U.S.C. § 523(a)(2)(A). Section 523(a)(4) states that a debtor will not be discharged from any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. See 11 U.S.C. § 523(a)(4). Section 523(a)(6) states that a debtor will not be discharged from any debt for willful and malicious injury to another entity or another entity's property. See 11 U.S.C. § 523(a)(6). Section 523(a)(9) states that a debtor will not be discharged from any debt for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated from alcohol, drugs, or other substances. See 11 U.S.C. § 523(a)(9).

These statutes expressly memorialize the Congressional intent to discourage harmful and antisocial behavior by refusing to limit a debtor's liability for damages caused by tortious misconduct. Yet if the Court adopts El Toro's position, this would be precisely the result – El Toro's liability for waste, nuisance, and trespass would be severely limited under section 502(b)(6) because the same conduct would also constitute a violation of the Lease provision requiring El Toro to "obey all laws," and hence would be subject to the section 502(b)(6) cap.

El Toro's interpretation of section 502(b)(6) would produce pernicious results. As the Ninth Circuit reasoned:

> If the tenant's debt to the landlord already exceeded the cap then there would be no deterrence against even the most flagrant acts in violation of the lease, possibly even to the point of the tenant burning down the property in a fit of pique. Absent clear statutory language supporting such an absurd result, we cannot suppose that Congress intended it.

In re El Toro Materials Co., 504 F.3d at 981.

Numerous other examples also demonstrate the "absurdity" of El Toro's position. A tenant could breach a lease requiring compliance with all laws by wrongfully burying nuclear waste on the leasehold property. Under El Toro's interpretation of section 502(b)(6), the landlord's claim would be limited to a small percentage of future rent despite the fact that the leasehold estate might be unusable for centuries. Another example would be a tenant who violated a lease provision prohibiting it from extracting minerals by mining gold. Under El Toro's interpretation of section 502(b)(6), the landlord's damages for conversion would be limited to a small percentage of future rent even if it converted millions of dollars of precious metal by its wrongful acts. Application of the section 502(b)(6) cap to insulate the tenant from the economic consequences of this wrongful and antisocial behavior is contrary to the plain language of the statute and would violate sound social policy by encouraging injurious conduct, especially in

circumstances, as here, where the monthly rent is de minimis and the damages prodigious.

As stated by the Ninth Circuit, El Toro's interpretation of section 502(b)(6) would also be "inconsistent" with the goal of providing compensation to each creditor in proportion to what it is owed. In re El Toro Materials Co., 504 F.2d at 980. For example, if a tenant wrongfully discharged hazardous waste into the groundwater and damaged the leasehold property and several adjacent properties, and all land owners submitted claims in the tenant debtor's bankruptcy case, under El Toro's theory the adjacent property owners' claims would be allowed in full and the identical claim by the landlord would be capped under section 502(b)(6) as a small percentage of future rent. Such damages clearly did not result from the termination of the tenant's lease. Application of the section 502(b)(6) cap under these circumstances would thus be inconsistent with the plain language of the statute and would violate the goal of the Bankruptcy Code by forcing similarly situated creditors having the same priority claims to share disproportionately in the estate's assets.

El Toro's argument also is falsely premised on the assertion that when the same conduct creates tort liability and also breaches a contractual duty contained in the Lease, the resulting damages are all lease "termination damages" subject to the section 502(b)(6) cap. El Toro fails to recognize that tort and contract damages are not the "same damages." Settled law holds that they are different damages, based on different legal theories, and fundamentally different social policies.

Both El Toro and the Church agree that the substantive tort claims are to be determined by California law. Settled California decisions recognize that contract law and tort law serve different purposes. "Contract law exists to enforce legally binding agreements between parties; tort law is designed to vindicate social policy." Applied Equipment Corp. v. Litton Saudi Arabia Ltd., 7 Cal.4th 503, 514-15 (Cal. 1994) (citation omitted). Contract actions are designed to protect the parties' interest in having their promises performed. Id. Tort actions are designed to protect every person's interest in freedom from various types of harm. Id. The duties of conduct that give rise to tort actions are based principally on social policy, not on the parties' agreement. Id.

California courts have long held that conduct constituting a breach of contract may also be tortious. See, e.g., Jones v. Kelly, 208 Cal. 251, 254-55 (Cal. 1929) (citations omitted) (tort may exist even though it incidentally involves a breach of contract); Stoiber v. Honeychuck, 101 Cal. App. 3d 903, 919 (Cal. Ct. App. 1980) (citation omitted) ("It is hornbook law that an act that constitutes a breach of contract may also be tortious."). The legal duty to abstain from injuring another person is independent of the contract and attaches over and above the contract terms. See Jones, 208 Cal. at 255. Conduct amounting to a breach of contract becomes tortious when it also violates an independent duty arising from principles of tort law. See Applied Equipment Corp., 7 Cal. 4th at 515.

Accordingly, tort claims and contract claims may exist between landlords and tenants based on the

same misconduct. See Muro v. Superior Court, 184 Cal. App. 3d 1089, 1096 n.4 (Cal. Ct. App. 1986) (contract and tort claims are available for breach of the implied warranty of habitability); Pappas v. Carson, 50 Cal.App.3d 261, 268-269 (Cal. Ct. Ap. 1975) (tenant can be liable for negligently causing fire at leased property). The Supreme Court of California has held,

> A tort and trespass is none the less such because it incidentally involves a breach of the contract. The law imposes the obligation that 'every person is bound without contract to abstain from injuring the person or property of another, or infringing upon any of his rights.' (Sec. 1708, Civ. Code.) This duty is independent of the contract and attaches over and above the terms of the contract. This being so, the plaintiffs may treat the injury as a tort or as a breach of contract at their election. . . . The situation as presented by the pleadings, we think, is well encompassed by the following excerpt from Rich v. New York Cent. & H. R. R. R. Co., 87 N. Y. 382: 'It may be granted that an omission to perform a contract obligation is never a tort, unless that omission is also an omission of a legal duty. But such legal duty . . . may spring from extraneous circumstances not constituting elements of the contract as such, although connected with and dependent upon it and born of that wider range of legal duty which is due from every man to his fellow, to respect his rights of property and person, and refrain from invading them by force or fraud.' A tort may grow out of or make a part of, or be coincident with a contract. The fact

> that there existed a contract between the plaintiffs and the defendant would not immune the latter from the penalty that is ordinarily visited upon tort-feasors.

Jones, 208 Cal. at 254-55 (citations omitted); see also Applied Equipment Corp., 7 Cal. 4th at 515 (quoting, with approval, Jones, 208 Cal. at 255).

It is settled law that a violation of duties created by the Governmental Requirements may be the basis for tort claims. See Pacifica Homeowners' Assn. v. Wesley Palms Retirement Community, 178 Cal. App. 3d 1147, 1152-53 (Cal. Ct. App. 1986) (individual may sue in nuisance for violation of zoning ordinances and conditional use permits). The court in Castillo v. Friedman, 197 Cal. App. 3d Supp. 6 (Cal. Super. Ct., App. Div. 1987), aptly states the rule:

> It is well settled in California that '[violation] of a statute embodying a public policy is generally actionable even though no specific remedy is provided in the statute; any injured member of the public for whose benefit the statute was enacted may bring an action.' The above rule is applicable as well to city or county ordinances.
>
> The effect of such statutes, in essence, is to create a duty or standard of conduct, the breach of which, where it causes injury, gives rise to liability in tort. . . . '[T]he court may . . . accord to an injured member of the class a right of action, using a suitable existing tort action or a

> new cause of action analogous to an existing tort action.'

Id. at 14 (citations omitted) (violation of rent stabilization ordinance).

El Toro "is subject to orders of any Federal, State, or local regulatory body to the same extent as the debtor would be if a petition commencing the case under [chapter 11] had not been filed." 11 U.S.C. § 1166. Debtors in bankruptcy also have a duty to obey all federal and state laws and regulations. See 28 U.S.C. § 959(b). El Toro was thus required to comply with the Governmental Requirements independent of the Lease covenant requiring it to obey all laws, and this was true whether or not El Toro's Lease was rejected or terminated.

As owner of the Subject Property, the Church is in a class of individuals and entities intended to be benefited and protected by the Governmental Requirements imposed on El Toro. El Toro thus has duties to the Church (and to the public) to fulfill El Toro's reclamation obligations, and to perform the requirements of El Toro's CUPs and Reclamation Plan. These duties exist independently of the termination of El Toro's Lease.

El Toro's violations of the Governmental Requirements trigger its liability to the Church for nuisance, trespass, and waste. California Civil Code sections 3479, 3491, and 3501 define a nuisance as "anything which is injurious to health . . . or is indecent or offensive to the senses, or an obstruction to the free use of property, so as to interfere with the

comfortable enjoyment of life or property . . . ." Cal. Civ. Code § 3479. The Bankruptcy Court appropriately concluded that leaving more than 1,000,000 tons of Wet Clay, debris, and rubble on the Subject Property was an obstruction to the free use of the Church's property so as to interfere with its comfortable use of its land and thus the Church properly stated a nuisance claim.

The Church also established a claim against El Toro for trespass. A trespass occurs when (1) plaintiff owns an interest in the property and has a right to exclusive possession, (2) defendant wrongfully occupies or otherwise invades the owner's right to possession, (3) plaintiff does not consent to defendant's use, (4) plaintiff was harmed, and (5) defendant's conduct was a substantial factor in causing plaintiff's harm. See Cal. Civ. Code §3334; Wilson v. Interlake Steel Co., 32 Cal. 3d 229, 232-33 (Cal. 1982); Herond v. Bonsall, 60 Cal.App.2d 152, 155-56 (Cal. Ct. App. 1943).

If a plaintiff landlord originally leased property to the defendant, and the defendant holds over beyond the leasehold term, the landlord has the option to treat the tenant as a trespasser. As the court in Peter Kiewit Sons' Co. v. Richmond Redevelopment Agency, 178 Cal. App. 3d 435 (Cal. Ct. App. 1986), explains:

> When the term of a lease expires but the lessee holds over without the owner's consent, he becomes a tenant at sufferance. 'Since the possession of the tenant at sufferance is

> wrongful, the owner may elect to regard the tenant as a trespasser . . . .'

Id. at 445 (citations omitted).

El Toro's unlawful refusal to remove its stockpiled Wet Clay, debris, rubble, and equipment is a wrongful occupation of the Church's real property and renders it liable for trespass. In Don v. Trojan Constr. Co., 178 Cal. App. 2d 135 (Cal. Ct. App. 1960), the defendant construction company was building a subdivision near plaintiff's vacant lot and deposited dirt on plaintiff's property without plaintiff's consent. Id. at 136. The court held that the defendant had wrongfully occupied the property by depositing the dirt and, as a result, the plaintiff was entitled to recover damages for trespass. Id. at 138-139. Similarly, in Herond v. Bonsall, a commercial tenant who failed to remove restaurant and nightclub equipment from the leasehold premises after its lease expired was liable to the plaintiff landlord for damages based on trespass. 60 Cal. App. 2d at 155-56; see also Malden Mills Indus., Inc. v. Maroun (In re Malden Mills Indus., Inc.), 303 B.R. 688, 704-05 (B.A.P. 1st Cir. 2004) (discussing damages to be imposed on tenant at sufferance). El Toro's refusal to remove 1,000,000 tons of waste and debris when it abandoned the site renders it liable for trespass.

The facts also establish El Toro is liable for waste. California Civil Code § 826 and California Code of Civil Procedure § 732 state that a possessor of real property has a duty to refrain from injuring the owner's reversionary interests and the statutes provide remedies for this injury. The touchstone of a claim for waste is that it is an action by an out-of-

possession owner against an offending party in possession. See Smith v. Cap Concrete, Inc., 133 Cal. App. 3d 769, 774-75 (Cal. Ct. App. 1982) (emphasis added) ("[w]aste evolved and broadened from a cause of action designed to protect owners of succeeding estates against the improper conduct of the person ***in possession*** which harmed and affected the inheritance").

The waste tort action alone directly refutes Petitioners' assertion that "generation and storage of mining waste on the property did not produce a debt or claim or constitute a tort," Pet. at 29, that the Church "would have had no claim if El Toro had assumed the Lease," id., that "until the Lease was rejected and El Toro repudiated its removal and restoration obligations . . . SVCC [the Church] could not file a claim or claim to be harmed by El Toro's generation and storage of waste material," id. at 30, and that "it was only upon rejection of the Lease that El Toro breached the lease covenants obligating it to remove the settlement ponds and debris deposits," id.

Section 502(b)(6) caps damages "resulting from the termination of a lease of real property." 11 U.S.C. § 502(b)(6). The Church's claim for waste, which is a damage to the Church's non-possessory, reversionary interest, is the reverse of a claim that is capped. Indeed, the Church's damages for waste did not "result from the termination of a lease of real property," but rather, resulted from El Toro damaging the Church's reversionary interest over a period of years while El Toro's Lease was in effect and while El Toro occupied the site. Damages for this tort, and the Church's other

claims, thus clearly fall outside the plain statutory language of section 502(b)(6).

It is uncontested that El Toro's acts and omissions under the facts of this case give rise to tort claims in the Church's favor ***independently*** of the Lease. The Church's tort claims would exist even if the Lease had never been executed, rejected, or terminated. In addition, it is well settled under California law that El Toro can be simultaneously liable in both contract and tort for its failure to remove the stockpiled Wet Clay, equipment, debris, and rubble. Because the plain and unambiguous language of section 502(b)(6) caps only damages resulting from the termination of El Toro's Lease, and because the Church's tort claims exist independently of the Lease, El Toro's liability for damages caused by these independent torts is not capped by section 502(b)(6).

This result is consistent with the plain language and legislative history of section 502(b)(6), the will of Congress as ascertained from reading the Bankruptcy Code as an integrated whole, with the goal of allowing similarly situated creditors having the same priority claims to share equally in the assets of the estate, and sound public policy, which is furthered by not insulating a tort-feasor from a claim for damages to the full extent of the economic harm inflicted by his tortious injury to another's property. This result also is not inconsistent with any other circuit court opinion. For all these reasons, the Ninth Circuit opinion is correct and there is no important question of federal law that has not been, but should be, settled by this Court.

IX.
CONCLUSION

For the reasons stated herein, the Court should deny the Petition.

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